Aviation and the Internet

Committee on Commerce, Science, and Transportation
UNITED STATES SENATE

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Chairman McCain and esteemed members of the Senate Commerce Committee, we want to begin by thanking you for shining the spotlight on Orbitz and similar airline-owned entities that threaten to cripple competition in the U.S. air travel market.

This morning, we wish to request that the Congress should take all necessary steps to investigate and remedy the anticompetitive effects of Orbitz and other proposed Internet sites jointly owned, operated, and funded by consortiums of major U.S. and international air carriers.

We make this request on behalf of the Association of Retail Travel Agents ("ARTA"), a nonprofit trade association organized and existing under the laws of the District of Columbia and headquartered at 2692 Richmond Road, Suite 202, Lexington, Kentucky 40509-1542.

ARTA is the largest nonprofit association in North America representing travel agents exclusively, with more than 4,600 travel agent members in the United States and Canada. Most of ARTA's travel agent members are appointed by the Airlines Reporting Corporation ("ARC") to sell airline tickets to the public, including tickets on the air carriers identified as joint owners of the Internet sites in question. In the sale and distribution of airline tickets to the public, regardless of the sales methods used (e.g., telephone, fax, Internet, in-person agency visit), these ARTA members compete for sales with the airlines themselves.

On November 9, 1999, four U.S.-based air carriers United Airlines, Delta Air Lines, Northwest Airlines, and Continental Airlines announced plans to launch a jointly owned Internet travel site in six months to sell airline, hotel, car rental, cruise, tour, and other travel services to the public. According to press reports, the jointly owned site will stand apart from competing Web sites by operating as a one-stop shopping location offering features such as exclusive discount fares and preferred seating arrangements available only through the airline-owned site. The new site named "T-2" by the press for "Travelocity Terminator" (a reference to the leading independent online travel agency) would be developed by the Boston Consulting Group, a Chicago-based general management consulting firm.

On January 13, 2000, 23 additional U.S.- and foreign-based air carriers signed letters of intent to become charter associates in T-2: American, USAirways, ATA, AirTran, Hawaiian, Midwest Express, Midway, Vanguard, Air Canada, Air Jamaica, Air New Zealand, Alitalia, All Nippon

Air, Austrian, British Midland, COPA, CSA Czech, Iberia, KLM, Korean, Mexicana, Singapore, and Varig. (American later joined the four founding airlines as an equity owner.)

On May 11, 2000, 11 European-based air carriers announced the creation of a similar jointly owned site (dubbed "Me-Too" by travel trade editors): Aer Lingus, Air France, Alitalia, Austrian, British Airways, British Midland, Finnair, Iberia, KLM, Lufthansa, and SAS.

Relying heavily upon Antitrust Guidelines for Collaborations Among Competitors (issued jointly by the Federal Trade Commission and by the U.S. Department of Justice in April, 2000), ARTA alleges nine separate concerns that, taken separately or jointly, support the contention that these airline-owned sites harm competition by increasing the ability or incentive profitably to

raise price above or reduce output, quality, service, or innovation below what likely would prevail in the absence of the relevant agreement:

1. These airline-owned sites constitute a per se illegal agreement to share the domestic air travel market by allocating lines of commerce.

Currently, the airlines that own T-2 and Me-Too sell air travel via their own individual airline Web sites, via leading online travel agencies such as Expedia and Travelocity, and via independent travel agencies that have their respective agency Web sites with booking engines.

By combining assets, exclusive airfare discounts, frequent flyer mile promotions, preferred seating arrangements, and other competitive strengths not available through the other retail channels, T-2 and Me-Too will succeed eventually in crippling or destroying other online retail outlets for air travel leaving these air carriers (collaborating openly via the two sites) in complete control of the online travel sales market.

The overall competitive effect of these agreements is the concerted, deliberate re-allocation of online air travel commerce by air carriers from a somewhat competitive mix of independent single-airline sites, independent online travel agencies, and independent retail travel agencies with their own Web sites to a single-channel distribution system controlled directly by consortiums of U.S. and international airlines.

These consortiums can claim not one single true efficiency in this collaboration.

Typically, participants in an efficiency-enhancing integration combine assets to achieve procompetitive benefits that they could not achieve separately. However, the individual air carriers in these consortiums operate their own respective successful Internet sites, and they sell growing amounts of air travel via online travel agencies that earn "capped" commissions. Because equal or comparable procompetitive benefits may be achieved through these practical, significantly less restrictive means, the T-2 and Me-Too agreements are therefore not reasonably necessary.

2. These airline-owned sites limit independent decision making by the competing air carriers.

In launch announcements, the Boston Consulting Group and its airline clients make clear their intention to enforce collective policies on competitively significant variables such as quality, service, and promotional strategies to increase market power in effect, "to create the most comprehensive travel site on the Web." USA Today, Nov. 10, 1999, B-1. "Identical to the commitments of the initial airline partners [United, Delta, Northwest, and Continental], the additional [23] airlines will provide a number of services to the site including co-op marketing programs, access to customer loyalty programs and exclusive marketing support." BusinessWire, January 13, 2000, emphasis added.

In effect, this agreement reduces the individual airlines' control over assets necessary to compete and thereby reduces their ability to compete independently. Also, it combines the financial interests of the individual air carriers into a single jointly owned site in ways that undermine incentives for the airlines to compete independently (e.g., the single site reduces or eliminates comparative airline advertising, thereby harming competition by restricting information to consumers on price and other competitive significant variables).

3. These airline-owned sites facilitate horizontal collusion.

T-2 and Me-Too will greatly increase the temptation for their airline owners

to engage in practices of price signaling, display bias, and price fixing that air carriers have attempted and federal agencies have largely succeeded in preventing in other airline-owned electronic media, notably computerized reservation systems ("CRSs") and the Airline Tariff Publishing Company ("ATPCO").

Prior to its demise in 1985, the Civil Aeronautics Board ("CAB") found that the domestic airlines that owned CRSs displayed information on the system screens viewed by travel agents in a way that favored their own flights over the flights of competing airlines that may have been better choices from the consumer's perspective. The CAB adopted regulations (currently enforced by the Department of Transportation) to eliminate "display bias" so that travel agents and consumers could receive objective and accurate flight information about all air carriers listed on respective CRSs. See 14 C.F.R. 255.1-255.12.

In 1992, the Department of Justice filed suit against eight major U.S. airlines alleging that they colluded to raise prices and restrict competition by signaling airline price changes through elaborate footnotes and codes filed with ATPCO (a central computer system owned by the airlines that distributes changes in ticket prices to major airlines and CRSs). Two years later, the air carriers settled the suit by agreeing to restrictions on the use of ATPCO footnotes and codes and to a prohibition on pre-announcing price increases except where widely publicized. (In April, 2000, Rep. Peter DeFazio asked the Justice Department to review the airline industry's current compliance with the 1994 settlement.)

The T-2 and Me-Too sites raise the very strong probability that this horizontal collusion prohibited and largely eliminated by federal agencies in other contexts would be resurrected on the Internet.

For example, the airline owners of these sites will share in electronic formats that make data manipulation a simple process information relating to price, output, costs, and strategic planning, as well as current operating and future business plans. These data will be available as individual company data,

rather than aggregated data, so that respective airline owners can identify individual firm data in effect, "automating" the horizontal collusion.

Further, ARTA alleges that the T-2 and Me-Too sites foster express or tacit collusion among the airline owners and charter members in a manner akin to the coordinated interaction theories outlined in Horizontal Merger Guidelines at 14.

4. These airline-owned sites lead to unhealthy levels of market concentration.

"In some cases . . . a determination of anticompetitive harm may be informed by consideration of market power." Antitrust Guidelines at 12.

Just as the major U.S. air carriers have developed "fortress hubs" to carve up and protect their respective shares of the U.S. air travel market, the T-2 and Me-Too jointly owned sites will become "fortress Web sites" that the owner airlines will use ultimately to inflate airfares, curtail consumer choices, and choke competition posed by smaller rival airlines and independent retailers.

On the one hand, "market share affects the extent to which participants or the collaboration must restrict their own output in order to achieve anticompetitive effects in a relevant market." Antitrust Guidelines at 17. The larger the percentage of total supply that a firm controls, the less severely it must restrict its own output in order to produce a given price increase, and the more likely it is that an output restriction will be profitable.

In the case of the T-2 site, the collective market share of the participating domestic airlines (as owners or as charter members) totals as follows (figures reflect revenue passenger miles obtained from the current volume of Aviation Daily Data at 88, and the total reflects rules found in the Federal Trade Commission's 1992 Horizontal Merger Guidelines for calculating market share):

United

19.07% share

American

16.95% share

Delta
15.96% share
Northwest
11.29% share
Continental
9.06% share
USAirways
6.26% share
American Trans
Air 1.70% share
Hawaiian
0.73% share
AirTran Holding
Corp. 0.52% share
Midwest Express
0.30% share
Midway Airlines
0.15% share
Vanguard
0.13% share

The airline owners and charter members of T-2 control an extraordinary 82.12% domestic market share an almost unprecedented stranglehold being brought to bear on the online travel marketplace.

On the other hand, "market concentration affects the difficulties and costs of achieving and enforcing collusion in a relevant market." Antitrust Guidelines at 18. The Federal Trade Commission uses the Herfindahl-Hirschman Index ("HHI") as an aid to interpret market concentration data.

Calculated by summing the squares of the individual market shares of all participants, the HHI results before and after the formation of T-2 show a tremendous difference:

HHI before T-2
1,215

HHI after T-2
6,800

"When the post-merger HHI exceeds 1,800, it will be presumed that mergers producing an increase in the HHI of more than 100 points are likely to create or enhance market power or facilitate its exercise." Horizontal Guidelines at 13. In the case of T-2, the airlines' joint forces will result in an extraordinary increase in their collective market power as measured by the HHI.

(ARTA argues that the joint ownership and operation of T-2 constitutes, in practical terms, a merger of significant corporate resources, meeting the general requirements of the HHI instrument.)

ARTA echoes the prescient comments of former CAB Chairman Alfred Kahn: "[W]hen I see what can only be described as real monopolistic exploitation of travelers with limited alternatives, I do worry about the sufficiency of competition in the airline industry." Conde Nast Traveler, Sept. 1998, 132.

5. These airline-owned sites fail the "safety zone" test.

Section 4.2 of the Antitrust Guidelines outlines a "safety zone" to provide participants in a collaboration with a degree of certainty in those situations in which anticompetitive effects are so unlikely that the arrangements are presumed to be lawful without inquiring into particular circumstances. "Absent extraordinary circumstances, the Agencies do not challenge a competitor collaboration when the market shares of the collaboration and its participants collectively account for no more than twenty percent of each relevant market in which competition may be affected." Antitrust Guidelines at 26.

The airline owners and charter members of T-2 control an extraordinary 82.12% domestic market share more than four times the maximum threshold of the "safety zone" outlined by the Federal Trade Commission in the Antitrust Guidelines.

6. These airline-owned sites fail four of six factors affecting the ability of the participants to compete independently of each other.

Among the six factors listed in Antitrust Guidelines at 19, the T-2 and Me-Too sites fall short in four areas:

"(c) the nature and extent of participants' financial interests in the collaboration or in each other;"

The greater the financial interest in the collaboration, the less likely is the participant to compete with the collaboration. In the case of T-2, the five equity airline owners United, Delta, American, Northwest, and Continental control a 100% interest in the site, according to press reports. Therefore, they will receive a lower net return from aggressive independent collaboration.

"(d) the control of the collaboration's competitively significant decision making;"

"[T]he collaboration is less likely to compete independently as participants gain greater control over the collaboration's price, output, and other competitively significant decisions." Antitrust Guidelines at 20. As full equity owners, the primary owners United, Delta, American, Northwest, and Continental will presumably make final decisions regarding T-2's operations, staffing, and promotions. Further, they will presumably exert veto rights such as the refusal of new entrant airlines as participants of T-2.

"(e) the likelihood of anticompetitive information sharing;"

Given the concerns outlined in section 3 of this letter, ARTA alleges that the likelihood of anticompetitive information sharing by the airline owners and charter members of T-2 and Me-Too is extremely high.

"(f) the duration of the collaboration."

"In general, the shorter the duration [of the collaboration], the more likely participants are to compete against each other and their collaboration." Antitrust Guidelines at 21. In this case, T-2 and Me-Too are designed to operate as permanent Internet sales sites, reducing effectively the incentives for

their airline owners and charter members to compete independently.

While the adoption of appropriate safeguards to prevent anticompetitive information sharing may mitigate such concerns, the track record of these airlines as outlined in section 3 of this letter speaks against any reasonable reliance simply upon the good faith of the air carriers involved.

7. These airline-owned sites exclude entry by new online travel agencies and by new start-up airlines.

The proven difficulty of entry by start-up air carriers and online travel agencies in competing against the airline owners and charter members of T-2 and Me-Too in traditional avenues is well documented. In this instance, that track record supports ARTA's contention that entry by new or additional competitors would not be "timely, likely, and sufficient in its magnitude, character and scope to deter or counteract the anticompetitive harm of concern." Antitrust Guidelines at 22.

In 1999, the Federal Trade Commission recommended a review of the planned acquisition of Ingram Book Group by Barnes & Noble, arguing that the control of an important part of the book distribution marketplace might enable Barnes & Noble to shut off competing sellers from Ingram's services or to deny access on competitive terms, thereby raising the costs of Barnes & Noble's rivals. Ultimately, the acquisition would have led to less competition on the Internet for bookselling. In the same vein, ARTA argues, the T-2 and Me-Too transactions will lead ultimately to less competition on the Internet for travel sales.

8. These airline-owned sites pose an enormous threat to the online privacy interests of traveling consumers.

T-2 and Me-Too generate substantial questions about the confidentiality of traveling consumers' personal data and the sharing of that data among the sites' airline owners and charter members.

Typically, online sites run by air carriers collect a larger than usual assortment of personal data, including emergency contacts, passport and visa information, and other details beyond the consumer's contact information and credit card information collected by other e-commerce sites. Accordingly, the risks of misuse of these data rise in proportion.

In particular, ARTA argues that federal regulators should examine carefully the anticompetitive effects of the merging of online and offline data by these airline owners and charter members. See "Electronic Commerce and Beyond: Challenges of the New Digital Age" by FTC Chairman Robert Pitofsky, Woodrow Wilson Center "Sovereignty in the Digital Age" Series, Feb. 10, 2000.

9. These airline-owned sites support price discrimination based on the "digital divide."

The announced sales policies of T-2 and Me-Too to offer special discount airfares and reservation benefits available exclusively through these Internet sites greatly exacerbate the negative effects of the "digital divide" facing consumers.

According to National Telecommunications and Information Administration (NTIA) surveys, whites are more likely to have access to the Internet (particularly from home) than Blacks or Hispanics have from any location. At almost every income level, households in rural areas are significantly less likely to have Internet access than those in urban or central city areas. More than 61 percent of those with college degrees now use the Internet, while only 6.6 percent of those with an elementary school education or less use the Internet; in fact, this gap actually widened by 25 percent from 1997 to 1998. While almost 59 percent of Americans making more than US$75,000 frequent the Internet from any location, only 16 percent at the lowest end of the pay scale (US$5,000-US$10,000) use the Internet. See "Falling Through the Net: Defining the Digital Divide," NTIA, July 1999.

While consumers across racial and socioeconomic boundaries may counter a lack of Internet access by shopping more aggressively in

local markets e.g., they can generally find local sales prices on compact discs sold at similar discounts on the Internet the special sales and exclusive airfares available through T-2 and Me-Too cannot be found by consumers shopping locally through traditional retailers or through the airlines' traditional direct sales methods (e.g., toll-free reservation numbers).

Though the T-2 and Me-Too sites are not yet functional, ARTA argues that the very nature of the agreement governing these collaborations between competitors jointly controlling more than 80 percent of the domestic airline market "give[s] rise to an intuitively obvious inference of anticompetitive effect." California Dental Ass'n v. FTC, 119 S. Ct. 1604, 1617-18 (1999). As the Antitrust Guidelines state, federal regulators will challenge agreements without a detailed market analysis in cases where "the likelihood of anticompetitive harm is evident from the nature of the agreement . . . absent overriding benefits that could offset the anticompetitive harm . . . "
Antitrust Guidelines at 4.

Further, Congress should act swiftly in order to be sensitive to the reasonable expectations of participating "charter agreement" air carriers that have made significant sunk cost investments in reliance on the T-2 and Me-Too agreements which may later be judged anticompetitive.

Thank you for the opportunity to submit this testimony today.